The Allocation of Estate Taxes by Judicial Rule: A Case for Reform

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The hallmark of an effective estate plan is the precise implementation of all planning objectives. One planning objective of crucial importance is to determine the impact of charging various interested parties with the ultimate burden of death taxes. Ideally, the burden is borne by those persons designated by the estate owner through the estate plan. Since the implementation of the plan can be considered successful only when it unmistakably carries out the owner's wishes, the provision directing the allocation of death taxes must be clearly expressed.

No estate plan should be considered complete without a careful consideration of the funds to be used to pay estate taxes. An estate plan which does not produce a distribution among intended beneficiaries and in intended amounts is a failure regardless of how fairly the ultimate burden of estate taxes is distributed by the courts or by post-mortem agreements between the interested parties. While the importance of draftsmanship should not be underestimated, this article is not devoted to the methods of careful explication and adequate provision,[1] but rather to the manner in which the estate tax burden is shared by persons interested in the taxable estate when a testator fails to effectively fix the burden.

While all states grant individuals the option of directing how the death tax burden is to be allocated among interested persons,[2] states differ in their approach to the method of allocation when the decedent fails to control the burden effectively. The decisional law of the decedent's domicile determines the ultimate burden for death taxes in the absence of an apportionment statute or a controlling tax clause.[3]

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1. A tax allocation clause must be clear and unequivocal, especially when the burden is shifted from where the law would otherwise have placed it. The need for clear expression is illustrated by the position taken by Ohio courts that a general testamentary direction to pay all debts and taxes from the estate is not sufficiently indicative of intention to have the probate estate pay the estate taxes generated by nonprobate property. *See* In re Estate of Gatch, 153 Ohio St. 401, 92 N.E.2d 404 (1950).

2. Minan, *A Scrivener's "Delight"—The Marital Deduction Formula Clause*, 37 OHIO ST. L.J. 81, 91 (1976).

3. Riggs v. Del Drago, 317 U.S. 95 (1942). The burden of death taxes may be shifted by tax clauses in documents that are other than testamentary in nature. An inter vivos trust, for example, that is includible in a decedent's gross estate for purposes of death taxation may direct that the trustee contribute to the payment of taxes.

The issue of who ultimately bears the estate tax burden should be distinguished at the outset from the general principle that federal[4] and state[5] law require the personal representative of the decedent's estate to pay the death taxes. The fact that the personal representative initially pays the tax does not determine who ultimately will bear the estate tax burden. The personal representative's obligation is imposed for the purpose of convenience of tax collection and not for the purpose of fixing the final estate tax burden.[6]

States employ either full apportionment,[7] partial apportionment,[8] or the burden on the residue rule[9] when the decedent fails to fix the estate tax burden. Under full apportionment the death tax liability is shared by all persons interested in the estate in the proportion that the value of the property received bears to the total value of all property in the gross estate. In making the apportionment, however, those shares that generate no tax, such as gifts to a spouse or to a charity, are

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4. I.R.C. § 2002 provides that the federal estate tax shall be paid by the executor. Treas. Reg. 20.2002-1 extends this obligation to the administrator of a decedent's estate.

5. OHIO REV. CODE ANN. § 5731.21 (Page 1973).

6. As to life insurance and property over which the decedent had a general power of appointment, Congress has provided that the portion of the estate attributable to those assets be borne by them; however, the decedent retains the power to direct otherwise. I.R.C. §§ 2206, 2207.

7. Apportionment as to all assets: ALASKA STAT. § 13.16.610 (1973); ARK. STAT. ANN. § 63-150 (1971); CAL. PROB. CODE § 970 (West 1956); CONN. GEN. STAT. ANN. § 12-401 (West 1958); DEL. CODE ANN. tit. 12, § 2901 (Michie 1974); HAW. REV. STAT. § 236A-2 (1976); IDAHO CODE § 15-3-916 (Supp. 1977); IND. CODE ANN. § 29-2-12-1 (Burns 1972); Gratz v. Hamilton, 309 S.W.2d 181 (Ky. 1958) (dictum); LA. REV. STAT. ANN. § 9:2432 (West 1965); MD. EST. & TRUSTS CODE ANN. § 11-109 (1974); MICH. COMP. LAWS ANN. § 720.12 (1968); MINN. STAT. ANN. § 524.3-916 (West 1975); NEB. REV. STAT. § 77-2108 (1976); NEV. REV. STAT. § 150.310 (1975); N.H. REV. STAT. ANN. § 88-A:2 (1970); N.J. STAT. ANN. §§ 3A:25-30 to -33 (West 1953); N.Y. EST. POWERS & TRUSTS LAW § 2-1.8(a) (McKinney 1967); N.D. CENT. CODE § 30.1-20-16 (1976); OR. REV. STAT. § 116.313 (1975); PA. CONS. STAT. ANN. § 3702 (Purdon 1975); R.I. GEN. LAWS § 44-23.1-2 (Supp. 1976); S.D. COMPILED LAWS ANN. § 29-7-1 (1976); TENN. CODE ANN. § 30-1117 (1977); UTAH CODE ANN. § 75-3-916 (1977); VT. STAT. ANN. tit. 32, § 7302 (Supp. 1977); VA. CODE § 64.1-161 (1973); W. VA. CODE § 44-2-16a (1966); WYO. STAT. § 2-338 (Supp. 1975).

8. Apportionment as to nonprobate assets: In re Estate of Garcia, 9 Ariz. App. 587, 455 P.2d 269 (1969) (probate assets); Doetsch v. Doetsch, 312 F.2d 323 (7th Cir. 1963) (applying Arizona law to nonprobate assets); FLA. STAT. ANN. § 733.817 (West 1976); MASS. ANN. LAWS ch. 65A, § 5 (Michie/Law Coop. Supp. 1977); Carpenter v. Carpenter, 364 Mo. 782, 267 S.W.2d 632 (1954); In re Estate of Marans, 143 Mont. 388, 390 P.2d 443 (1964); In re Gallagher's Will, 57 N.M. 112, 255 P.2d 317 (1953); McDougall v. Central Nat'l Bank, 157 Ohio St. 45, 104 N.E.2d 441 (1952); S.C. CODE § 65-563 (Supp. 1975).

9. Burden on the residue: ALA. CODE tit. 51, § 449(1) (1958); Ramsey v. Nordloh, 143 Colo. 526, 354 P.2d 513 (1960); In re Estate of Collins, 269 F. Supp 633 (D.D.C. 1967); GA. CODE ANN. § 92-3401 (1974); ILL. ANN. STAT. ch. 3, § 18-14 (Smith-Hurd 1975); IOWA CODE ANN. § 633.449 (West Supp. 1977); Spurrier v. First Nat'l Bank, 207 Kan. 406, 485 P.2d 209 (1971); Old Colony Trust Co. v. McGowan, 156 Me. 138, 163 A.2d 538 (1960); MISS. CODE ANN. § 27-9-33 (1972); Park v. Carroll, 18 N.C. App. 53, 196 S.E.2d 40 (1973); Tapp v. Mitchell, 352 P.2d 900 (Okla. 1960) (nonprobate assets), In re Rettemeyer's Estate, 345 P.2d 872 (Okla. 1959); Sinnott v. Gidney, 159 Tex. 366, 322 S.W.2d 507 (1959) (at least as to probate assets); In re Estate of Eberle, 4 Wash. App. 638, 484 P.2d 478 (1971); In re Uihlein's Will, 264 Wis. 362, 59 N.W.2d 641 (1953); Estate of Joas v. Langrill, 16 Wis.2d 439, 114 N.W.2d 831 (1962) (nonprobate assets).

excused from contribution.[10] A majority of jurisdictions have adopted full apportionment.[11]

The burden on the residue rule, in contrast, places the tax liability on those persons who bear the burden of the debts and other expenses of the decedent's estate. Under this method of allocation the death taxes are paid from the estate in the same manner as any other debt of the estate. In practice, this most frequently means that the residue of the estate is charged with the death tax liability when the decedent dies testate.[12] When the burden of the estate tax falls on the residue and more than one residuary beneficiary is named, each beneficiary automatically bears a proportionate part of the tax since the residuary shares are determined after the estate tax is calculated.[13] In the event that property passes by partial intestacy, or in the instance where the residuary is insufficient or nonexistent, the allocation of the death tax burden frequently follows the common law abatement pattern.[14]

Partial apportionment combines both methods of allocation. Under partial apportionment nonprobate assets bear a pro rata share of the estate tax, while the burden on the residue principle is retained for assets comprising the probate estate.

Certain states control the question of the ultimate burden of death tax liability by statute.[15] Ohio, however, has not adopted a statutory method of apportionment. The purpose of this article is to examine Ohio's method of allocating estate taxes in the most frequently encountered situations: when a testator fails to fix the estate tax burden effectively and when a surviving spouse elects against the testator's will. The thesis of this article is that Ohio's method of allocating estate taxes[16] as presently operated can frustrate a testator's predictable expectations. The first part of this article analyzes the development of the decisional rules on allocation when a decedent fails to fix the estate tax burden. The leading cases are analyzed in order to identify the deficiencies of the present structure. Since a dece-

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10. Kahn, *The Federal Estate Tax Burden Borne by a Dissenting Widow*, 64 MICH. L. REV. 1499, 1506 (1966).

11. *See* note 7 *supra*.

12. For example, in the intestate situation in Ohio when the probate estate generates the estate tax liability, and ratable sharing results through the interrelationship of OHIO REV. CODE ANN. §§ 2117.25 and 2105.06

13. In jurisdictions first calling on personal property in the residue to settle debts and costs of administration, including tax claims, before requiring contribution from real estate, the burden on the residue rule may not result in ratable sharing. *See*, Boehm, *Death and Taxes—I*, 22 OHIO ST. L.J. 327, 345 (1961).

14. *See* T. ATKINSON, LAW OF WILLS § 136 (2d ed. 1953).

15. For an illustration of the statutory approach to apportionment, see UNIFORM PROBATE CODE § 3-916, excerpted in note 79 *infra*.

16. The Ohio estate tax is a debt against the estate in the same manner as the federal estate tax. Spears v. Madden, 28 Ohio Misc. 125, 276 N.E.2d 669 (P. Ct. 1971).

dent's taxable estate most frequently consists of either probate and nonprobate assets or just probate assets, the cases are analyzed within this organizational framework. The second part of the article examines the method of allocating estate taxes when a surviving spouse elects against a will. It is devoted to an examination of the rationality of Ohio's system of allocating estate taxes in the election context. The final part of the article is devoted to an identification of the major policies that should be reflected in the statutory method of allocation and its interrelation with the election statute. The Uniform Probate Code is proposed to the legislature as a vehicle for the reform. The enactment of the Tax Reform Act of 1976, provides an opportunity for estate planners to re-examine and adjust all wills and estate plans to meet the changes in the new law. Similarly, the Ohio legislature should consider it an auspicious time to consider whether the continued allocation of estate taxes by judicial rule is desirable.

I. THE BURDEN ON THE RESIDUE RULE AND THE EMERGENCE OF EQUITABLE APPORTIONMENT

Shortly after Congress enacted the federal estate tax,[17] the Ohio Supreme Court decided a case that was influential in the development of the general proposition that federal estate taxes should not be apportioned when a testator fails to fix the estate tax burden. In *YMCA v. Davis*,[18] the court held that the residuary legatee bears the burden of the estate tax and the beneficiaries of the specific bequests are exonerated. The residuary legatees, who were tax exempt charities, were granted certiorari[19] by the United States Supreme Court for the purpose of examining the federal question whether the charities were deprived of the federal right to tax exemption secured by the Internal Revenue Code.[20] The United States Supreme Court held that the Code only required an estate tax deduction in the amount of the charitable gift and that federal law did not exempt the recipient of charitable gifts from taxation.[21]

The decedent in *Davis* had failed to designate in her will specifi-

17. Revenue Act of 1916, ch. 463, §§ 200-212, 39 Stat. 777-780. 1002 (1916) (now I.R.C. § 2001). For a discussion of the history of federal estate taxes see Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX. L. REV. 223 (1956).

18. 106 Ohio St. 366, 140 N. E. 114 (1922), *aff'd*, 264 U.S. 47 (1924).

19. 262 U.S. 739 (1923).

20. 264 U.S. 47, 49 (1924).

21. After the *Davis* decision many jurisdictions mistakenly concluded that Congress intended to specify who was to bear the burden of the estate tax liability. This mirage of supposed congressional intent was demolished, however, a few years later when the Supreme Court held:

> We are of opinion that Congress intended that the federal estate tax should be paid out of the estate as a whole, and that the applicable state law as to the devolution of property at death should govern the distribution of the remainder and the ultimate

cally who was to bear the estate tax burden. The executor filed a petition in the court of common pleas for construction of the will and for advice and direction concerning the federal estate tax and the distribution of the assets.[22] The fundamental issue before the Ohio Supreme Court was whether the residuary beneficiaries should bear the ultimate weight of the estate tax burden or whether it should be apportioned between the residuary and specific legatees. As a theoretical proposition the court was faced with a third possible alternative in resolving the dispute between the specific beneficiaries and residuary legatees. The residuary legatees could have been exonerated from bearing any estate tax burden with the burden thereby shifted to the specific beneficiaries.

Two reasons can be distilled from the Ohio court's decision to place the estate tax liability on the residuary legatees even though the assets passing to the charities generated no tax liability: the first was based on the nature of the estate tax, and the second on the intention of the testatrix. The nature of the estate tax, the court reasoned, was such that it had no relation whatsoever to any particular devise or legacy, or the right of any person to take or receive a portion of the estate.[23] It concluded that since the estate tax is a charge against the entire estate, and not against any particular bequest or legacy, as would be the situation if an inheritance tax were involved, the liability for the tax should be treated like the other charges, debts, and costs of administration.[24] The well-established principle that other charges, debts, and costs of administration are payable from the residue provided the court with the analytical foundation to conclude that estate taxes were to be similarly treated. The issue of which assets generated the estate tax liability did not, in the court's estimation, control the question of who was to bear the burden for the tax liability.

In contrast to an inheritance tax system, which is designed to tax the right to receive certain property, an estate tax clearly is not a charge against particular assets. The recognition of this fundamental difference between the nature of an estate tax and an inheritance

impact of the federal tax; accordingly, § 124 is not in conflict with the federal estate tax law . . . .

. . . It did not undertake in any manner to specify who was to bear the burden of the tax. Its legislative history indicates clearly that Congress did not contemplate that the Government would be interested in the distribution of the estate after the tax was paid, and that Congress intended that state law should determine the ultimate thrust of the tax. . . .

In reaching a contrary result, the court below relied primarily upon § 826(b). But that section does not direct how the estate is to be distributed, nor does it determine who shall bear the ultimate burden of the tax.

Riggs v. Del Drago, 317 U.S. 95, 97-100 (1942) (footnotes omitted).

22. 106 Ohio St. at 367, 40 N.E. at 114.

23. *Id.* at 369, 40 N.E. at 115.

24. *Id. See* Lauritzen, *Apportionment of Federal Estate Taxes*, 1 TAX COUNSELOR'S Q. 55 (1957).

tax does not mean, however, that the ultimate burden for the estate tax cannot or should not be placed on individual recipients of the estate. The estate tax burden is levied against the whole of the decedent's taxable estate and should not be viewed as an obligation of only the assets in the residuary but of all the assets in the taxable estate. This position is supported by the Internal Revenue Code provision that if the tax is not paid, the individuals in possession of the transferred property are personally liable for the tax to the extent of the value of the property.[25] The nature of the estate tax and its analogy to other charges, debts, and costs of administration is of doubtful analytical utility in the determination of who should ultimately be required to bear the burden of the tax.

The other basis of the *Davis* decision lies in that sovereign guide, intent. The court reasoned that

> it is to be presumed that a legacy specific as to the person, thing or amount, shall have priority over a mere general provision; especially, from its very nature, over all residuary devises and legacies.
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> . . . .
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> This fact affords a *clear and conclusive presumption* that all charges imposed by the law or by the testator should be paid out of the estate before any rights should ripen in behalf of the residuary devisees or legatees under this item [of the will].
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> This view supports the undoubted intention of the testator in the making of the will in all its various provisions.[26]

The petition at the trial level was for the construction of the testatrix's will concerning the allocation of estate taxes, and the testatrix's intention was supposedly of paramount importance in imposing the burden on the residuary legatees. The court, however, failed to see any significance in the circumstance that the testatrix's will was executed in 1914, some two years before the estate tax act was enacted. Obviously, the testatrix had neither intent with regard to the specific allocation of estate taxes nor realization of its impact. More-

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25. I.R.C. § 6324(a)(2) provides:

> If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees' trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person, except any part transferred to a purchaser or a holder of a security interest.

26. 106 Ohio St. at 369-70, 140 N.E. at 115 (emphasis added).

over, the conclusive presumption established by the Ohio Supreme Court subsumed the relevance of intent since no evidence was admissible to rebut it. The intention to charge the residuary with the burden for estate taxes was imputed and conclusive.

The *Davis* court observed that the use of a conclusive presumption supports the undoubted intention of the testator. The danger of implying intent with regard to allocating taxes from the nature of a residuary disposition is illustrated by *Plunkett v. Old Colony Trust Co.*,[27] which was cited approvingly by *Davis*. In *Plunkett*, the testator apparently wished to divide his estate between his two sons in approximately equal shares.[28] Unfortunately, there was no direction concerning who was to bear the estate tax burden. The Massachusetts court concluded that the residue, which had been bequeathed to only one son, should through the application of the burden on the residue rule bear the entire estate tax burden.[29] Assuming that the testator intended to divide his estate equally between his sons, the inference derived from characterizing the gifts as specific and residuary frustrated, rather than furthered, the testator's intent. Thus, the mechanical application of the burden on the residue rule with regard to the allocation of estate taxes can produce undesirable results.

The primary purpose in construing a will is to determine, if possible, a testator's actual intent rather than an intent presumed by law.[30] Under the *Davis* rationale a testator's silence on the allocation of the tax burden combined with the use of a residuary disposition renders the search for actual intent unnecessary. The problem with erecting a conclusive presumption, thereby rendering actual intent immaterial, is evident when the results obtained by applying the presumption are inconsistent with the testator's probable intent as in *Plunkett*. When the results suggest that actual intent is likely to be inconsistent with the intention presumed by the law, continued adherence to *Davis* is both unwise and unnecessary. Rules of construction should be flexibly applied to further the intention of the testator, and this cannot be accomplished if the search for actual intent is foreclosed by the application of a conclusive presumption.

Although the *Davis* court rejected the doctrine of equitable apportionment in favor of the burden on the residue rule, Ohio experienced the emergence of a limited application of the doctrine of

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27. 233 Mass. 471, 124 N.E. 265 (1919).

28. The provision for one son under the will and codicils was a gift outright of property valued at approximately $14,000 and a gift of property valued at little more than $382,000 to a trustee under a spendthrift provision, to pay income for life and a giftover of the remainder. The residue of the estate, valued at a little over $381,000, was bequeathed to the other son. *Id.* at 472, 124 N.E. at 265.

29. *Id.* at 474, 124 N.E. at 267.

30. 4 W. BOWE & D. PARKER, PAGE ON THE LAW OF WILLS § 30.1 (3d ed. 1961).

equitable apportionment in *McDougall v. Central National Bank Co.*[31] In *McDougall* the decedent died intestate leaving a taxable estate composed of both probate and nonprobate assets. The taxable nonprobate assets were held in an inter vivos trust. Since decedent died without a will, the issue of apportionment among testate beneficiaries was not involved as it was in *Davis*. The inclusion of the nonprobate assets in the taxable estate increased the estate tax. The personal representative paid the estate tax from the probate estate and then brought suit to recover an equitable portion of the tax generated by the nonprobate assets. Thus, the court was faced with the issue of whether the entire burden of the estate tax should fall on the probate estate or whether the nonprobate property should bear a proportional share of the tax. The court decided that the doctrine of equitable apportionment was applicable, and the estate tax burden was proportionally distributed among all interested parties.

In holding that the nonprobate assets should bear a proportional share of the federal estate tax liability, the court reasoned that "in the absence of any apparent intention of the decedent to the contrary, one who pays more than his share of that common obligation should be entitled to contribution from those who have not paid their share."[32] In other words, the right to contribution arises by reason of the compulsory discharge of more than the probate's share of a common obligation. The court also reasoned that when an individual dies intestate there is no reason for placing a greater burden on one part of the taxable estate than another since no expression of intent exists. This approach to the distribution of the estate tax burden is an application of the equitable concept of contribution.

If the principle of the *Davis* case had been found controlling in *McDougall*, the beneficiaries of the probate estate would have been required to bear the increase in the federal estate taxes due to the inclusion of the nonprobate assets in the taxable estate. Instead, the court fostered the partial emergence of the doctrine of equitable apportionment and distinguished *Davis* on the following basis:

> The instant case is not like *Young Men's Christian Assn. v. Davis, supra*, where, by the terms of her will, the testator indicated a preference for certain legatees by providing for them specifically and then specifically stating that what was left was to go to other legatees. In such an instance, especially where only probate assets are involved, it is apparent that those who are designated by the testator to take what is left over were intended by the testator to bear the burden of the debts, estate tax and other obligations of the estate, while the testator did not intend that those who were specifically provided for were to bear that burden.[33]

31. 157 Ohio St. 45, 104 N.E.2d 441 (1952).

32. *Id.* at 54-55, 104 N.E.2d at 446.

33. *Id.* at 58, 104 N.E.2d at 447.

The court rejected the argument that the trust agreement provided the necessary guidance on intent to charge the probate estate with the increased tax burden. Conceptually the argument was analogous to the contention advanced by specific legatees in *Davis,* that the structure of the will indicated an intent that the estate tax be paid out of the residue. The court rejected that argument in *McDougall* on the theory that a clear expression of intent was missing and that to conclude otherwise would be speculation. Once the court concluded that intent was absent, it was a short analytical step to the conclusion that the nonprobate trust assets contributed to the common obligation imposed on the estate, and that the doctrine of equitable contribution was proper.

The doctrine of equitable apportionment is based on the concept that the burden should be borne by all the persons upon whom it is imposed. Since the estate tax is a lien against the whole estate, the artificial concept of the two parts of a taxable estate does not destroy the concept that the federal estate tax structure contemplates but one taxable estate. The persuasiveness of this type of reasoning is evident when one examines the nature of lien for estate taxes.[34] Since the lien attaches to all property and rights to property belonging to such persons who are liable to pay the estate tax, the nonprobate beneficiaries should share in the cost of discharge.[35]

The formula to be used in determining the share of the federal estate tax that should be allocated to the nonprobate assets was articulated by the *McDougall* court as follows:

> [I]n determining the share of the common obligation represented by the estate tax which should be allocated to the trust estate, there appears to be no fairer or more reasonable approach than to compare the value for estate tax purposes of nonprobate assets which had an effect in generating estate tax liability with the value for estate tax purposes of probate assets which had that effect, and to allocate on that basis to nonprobate and to probate assets their proportionate share of the whole estate tax liability.[36]

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34. I.R.C. § 6324(a)(2).

35. Treas. Reg. § 301.6324-1(a)(1) (1972) provides:

> A lien for estate tax attaches at the date of the decedent's death to every part of the gross estate, whether or not the property comes into possession of the duly qualified executor or administrator. The lien attaches to the extent of the tax shown to be due by the return and of any deficiency in tax found to be due upon review and audit. If the estate tax is not paid when due, then the spouse, transferee, trustee (except the trustee of an employee's trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property, by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, shall be personally liable for the tax to the extent of the value, at the time of the decedent's death, of the property.

36. 157 Ohio St. at 58-59, 104 N.E.2d at 447-48.

Under *McDougall*, the judicial rules applying or rejecting the apportionment concept are operative only when the decedent fails to express an intent or when the intent cannot be implied. Since the decedent died intestate a vehicle for implying intent was not provided. In other cases, such as *Davis*, where the court is willing to conclusively presume intent from the characterization of gifts, equitable apportionment is inapplicable. The adoption of partial apportionment in *McDougall* was a reaction to the injustice inherent in the application of the rationale underlying the burden on the residue rule when the decedent's intent was neither expressed nor could be implied. To follow the principles underlying the burden on the residue rule in *McDougall* would have been to enrich the nonprobate beneficiaries at the expense of the probate estate. Thus, the decision furthers the policy of alleviating the effect of an unexpected tax burden upon the probate estate.

Although the testate counterpart of *McDougall* was some years in coming, it finally arrived in the case of *In re Estate of Penney*.[37] Decedent died testate leaving a taxable estate of approximately 14.5 million dollars; for tax purposes the probate assets were valued at about 4.7 million dollars and the nonprobate assets at a little more than 9.8 million dollars. The testator's will included charitable bequests, a marital deduction bequest designed to increase the marital deduction to the maximum amount, and a pour-over of the residuary to an inter vivos trust. Incredibly, no testamentary instructions on allocation of the estate tax burden were included. The inter vivos trust authorized the trustee, with the approval of the trust's advisory committee, to pay the executor a sufficient sum to discharge debts and all taxes of the estate in the event the assets available to the executor were insufficient.[38]

In the Tax Court the Internal Revenue Service argued that the testator intended for all the probate estate assets to be expended for the payment of estate taxes before funds were to be contributed by the trustee.[39] As a practical matter the success of this argument would result in the tax totally consuming the probate estate and cause the failure of the marital and charitable bequests. The estate, on the other hand, argued two distinguishable facets of the doctrine of equitable apportionment: first, that transfers generating no estate tax were exonerated from liability, and second, that the nonprobate trust assets includible in the gross estate for tax purposes must contribute to the federal estate tax, but those trust assets not generating tax should be exonerated.[40] The Tax Court held that the testa-

37. 504 F.2d 37 (6th Cir. 1974).

38. *Id.* at 39.

39. Estate of Penney v. Commissioner, 59 T.C. 102, 105-06 (1972).

40. *Id.* at 105.

mentary transfers qualifying for the marital and charitable deductions were required to contribute to the estate tax and that the inter vivos trust was also responsible for bearing a portion of the federal estate tax liability. This decision resulted in apportioning the tax between the probate and nonprobate estate, but in the process charged nonprobate assets that did not generate estate tax with a pro rata share of the tax.[41]

The estate appealed to the Sixth Circuit which held that to the extent that transfers of nonprobate assets were includible in the taxable estate but did not generate tax, *McDougall* dictated that such assets were not required to contribute. The court's reasoning was that the *McDougall* formula for determining the relative contribution to the common tax obligation included the ascertainment of the value of the nonprobate assets that "had an effect in generating estate tax liability."[42] Thus, since the allocation formula was dependent on a determination of nonprobate assets generating estate tax liability, those assets not generating additional tax liability should be excluded from consideration in applying the doctrine of equitable apportionment. Additionally, the court made the practical observation that nonexoneration would be " 'incredible' and contrary to what one would presume a testator's normal intent to be; that is, to maximize his deductions and minimize his tax liability."[43]

Under the *Penney* decision, nonprobate property qualifying for the marital or charitable deduction will not be obligated to contribute to the payment of the federal estate tax. But if the property qualifying for the deduction passes from the probate estate, the recipient will be required to contribute unless the surviving spouse or charity is a nonresiduary beneficiary and the residuary is sufficient to discharge the estate tax obligation, or a specific clause in the will exonerates the spouse or charity.

The triad of cases produces a peculiar framework of analysis. In *Davis* the decedent died testate with only probate assets. The fact that the decedent died testate was used as the principal basis of distinguishing it in *McDougall*, a case in which the decedent died intestate but with both probate and nonprobate assets. In *Penney* the decedent died testate, which would lead one to speculate that if the *McDougall* distinction was analytically sound *Penney* should be governed by the principles articulated in *Davis*. The formula established in *McDougall*, however, was used to resolve the question of contribution from the nonprobate assets even though the decedent died intestate. In addition, it should be realized that *McDougall* did not present the issue of whether nonprobate assets qualifying for the

41. *Id.* at 106-07.

42. 504 F.2d at 42.

43. *Id.* at 44.

marital or charitable deductions should be required to contribute to the payment of estate taxes. Yet, the *McDougall* formula of "generating estate tax liability," which was patently dictum, was used to resolve this question in *Penney*.

With the exception of the special situation of election against the will, the basic framework for the allocation of estate taxes was completed with the *Penney* decision.[44] Collectively *Davis*, *McDougall*, and *Penney* provide the judicial guidance for the allocation of estate taxes in Ohio when a decedent fails to fix the burden. To the extent nonprobate assets generate estate tax liability, they share in the discharge of the liability on the theory of equitable contribution. But when tax liability is generated by the probate estate alone, the doctrine of equitable contribution is rejected in favor of the burden on the residue rule.[45] Taxes are allocated to the residue as a result of a conclusive presumption.

The principle deficiency in Ohio's method of allocation lies in the thaumaturgic quality of the burden on the residue rule. Under *Davis*, once the judicial eye detects a residuary disposition the inquiry with regard to establishing actual intent is foreclosed by a conclusive presumption. Like any general expression of legal doctrine, it must be realized that the doctrine is not to be accepted and applied without limitation or reserve.

In general, if a testator is aware of the potential estate tax burden on the testamentary estate, a presumption that the burden is to be borne by the residue of the estate is reasonable and practical since it is consistent with the notion of knowledgeable awareness. Under these circumstances the inherent nature of a residuary bequest will reflect the actual intention of the testator. But if the presumption of knowledgeable awareness is the basis of charging the residue with estate taxes, the same presumption should be similarly applied when considering who should bear the estate tax burden by nonprobate assets. Not applying the presumption when nonprobate assets are included in the taxable estate is based on the speculative premise

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44. Although the reasoning in *Penney* has not been approved by the Ohio Supreme Court, it is highly probable that such approval will be forthcoming.

45. Under Ohio law, implying a preference from the distinction between specific and residuary dispositions is consistent with at least two other common situations, exoneration and abatement. Ohio statutorily follows the common-law rule of exoneration. OHIO REV. CODE ANN. § 2107.54 (Page 1976) provides in part:

> A devisee or legatee shall not be prejudiced by the fact that the holder of a claim secured by lien on the property devised or bequeathed failed to present such claim to the executor or administrator for allowance within the time allowed by sections 2117.06 and 2117.07 of the Revised Code, and the devisee or legatee shall be restored by right of contribution, exoneration, or subrogation, to the position he would have occupied if such claim had been presented and allowed for such sum as is justly owing thereon.

Ohio's approach to abatement is also consistent. *See* 6 R. HAUSER & A. DIENFENBACH, OHIO PRACTICE § 1018 (1969).

that the testator is aware of the estate tax consequences attendant with the inclusion of the probate assets in the taxable estate but unaware of the consequences associated with the nonprobate assets.

The predictable expectations of a testator should provide a limit on the judicial method of allocation. Mechanical adherence to the distinction between specific and residuary dispositions for the purpose of fixing the estate tax burden may produce some results which are both unfair and inconsistent with the testator's likely wishes. Judicial rules of construction are designed to accomplish results that are most likely to approximate the testator's desires and should be applied only to the extent that they advance that important objective. Common-sense arguments, founded upon the policy of obtaining the result most likely to be desired by a majority of persons making wills,[46] exist for disregarding the burden on the residue rule in cases when a beneficiary's share of the residue qualifies for a tax deduction. This will occur when the residuary beneficiary is a surviving spouse and the share qualifies for the marital deduction,[47] when a residuary beneficiary is a charity and the share qualifies for the charitable deduction,[48] or when a residuary beneficiary is an orphan and the share qualifies for the orphan's deduction.[49]

An estate is entitled to a deduction when the passage of property to the surviving spouse meets the technical requirements of the marital deduction.[50] If the spouse's bequest is contained in the residue, the deductible amount is reduced by taxes payable from the spouse's share of the residue under the burden on the residue rule, and an interrelated compounding of the estate tax liability exists.[51] This re-

46. Professor Powell incorporates this concept in the "normally operative rule." *See* Powell, *Ultimate Liability for Federal Estate Taxes*, 1958 WASH. U.L.Q. 327, 328 (1958).

47. I.R.C. § 2056. Property may be passed to the surviving spouse by any of four basic methods to qualify for the marital deduction: 1) outright devise or bequest; 2) a legal life estate coupled with the requisite power of appointment; 3) the creation of a trust whereby the surviving spouse has a life estate coupled with the requisite power of appointment; and 4) the creation of a trust whereby the surviving spouse has a life estate with the remainder payable to the surviving spouse's estate, the "estate trust." *See* Treas. Reg. §§ 20.2056(a)-2(b), 20.2056(b)-1-20.2056(b)-5 (1958).

48. I.R.C. § 2055. The discussion of the technical requirements needed to obtain a charitable deduction is beyond the scope of this article. In addition to outright gifts, the methods most frequently used to obtain the charitable deduction are the annuity trust (I.R.C. § 664 (d)(1)), the unitrust (I.R.C. § 664(d)(2)), or the pooled income fund (I.R.C. § 642(c)(5)).

49. I.R.C. § 2057. A deduction is available if the decedent does not have a surviving spouse and is survived by a minor child who is left with no known parent.

50. The most important substantive distinction between federal estate tax law and Ohio estate tax law is that there is no marital deduction for Ohio estate tax purposes. Ohio does, however, allow "an exemption equal to the value of any interest in property included in the value of the decedent's gross estate that is, or has been transferred to or for the benefit of and is vested in the surviving spouse." OHIO REV. CODE ANN. § 5731.15(A)(2) (Page Supp. 1977).

51. The compounding problem and its deleterious effect is aggravated by the Tax Reform Act of 1976. Under the Tax Reform Act the marital deduction with respect to estates having an

sults in a greater estate tax and less property passing to the surviving spouse and is predictably inconsistent with most testators' intentions. This application of the burden on the residue rule can drastically affect the testator's distribution plan. The residuary may be totally consumed in the payment of death taxes.

The typical estate plan customarily gives the residue of the estate to the paramount object of the testator's bounty.[52] When a testator gives a spouse a share of the residue, charging that share with estate taxes can also place the spouse at a severe economic disadvantage relative to the other beneficiaries of the estate. Rather than furthering the intent of the testator, the burden on the residue rule frustrates it when the surviving spouse's share of the residue qualifies for the marital deduction.

The idea that the testator has manifested a clear intention about the allocation of estate taxes by designating some beneficiaries as specific beneficiaries and others as residuary beneficiaries is not consistent with common sense, especially when the spouse is the residuary legatee. It is preposterous to think that a testator's intent is to have his spouse's share of the estate bear the brunt of the estate tax burden. The traditional rule of construction that compels such a result was developed at a time when the estate tax was quite different than it is today. *Davis*, which was the earliest principal case articulating the burden on the residue rule in the context of estate taxes, was decided prior to the adoption of the marital deduction[53] and during the period when estate taxes were relatively insignificant. Conditions have changed since then, and the Tax Reform Act of 1976 has made continued adherence to the burden on the residue rule particularly troublesome.[54] Since the Act increases the potential marital deduction and thus makes the potential loss greater, continued adherence to the present judicial method of allocating estate taxes results in a greater penalty when the surviving spouse is the beneficiary of the residue. Because of this, the principles stated in *Davis* should not govern the decisional path of cases that involve charging the surviving spouse's share of the residue with a pro rata share of the federal estate tax liability.

When the surviving spouse's residuary share of the probate estate does not generate additional estate tax liability the courts should be

adjusted gross estate of less than $500,000 has been liberalized. The estate may deduct up to $250,000 irrespective of the 50% limitation. Since the deduction is limited to the value that is passing or has passed from the decedent to the surviving spouse, failure to take advantage of the full marital deduction, which results from the compounding problem, more severely penalizes the estate and surviving spouse than under the former law. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 2002(a), 90 Stat. 1854 (amending I.R.C. § 2056(c)).

52. *E.g.*, 2 J. MURPHY, MURPHY'S WILL CLAUSES 198.1 (1977).

53. For a discussion of the background and purpose of the marital deduction, see C. LOWNDES, R. KRAMER, & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES, § 17.1 (3d ed. 1974).

54. *See* note 51 *supra*.

extremely reluctant to charge those assets with a pro rata share of the estate tax liability on the basis of traditional characterizations and inferences of intent. Rather than charging the spouse's share of the residue, the policy should be reversed so that there is exoneration. Such a change in policy is justifiable because it is logically consistent with the expectations of most, if not all, testators.[55] Furthermore, exoneration furthers the desirable policy of uniformity since non-probate assets qualifying for the marital deduction are exonerated. To a certain extent conformity with federal law is also obtained since the Internal Revenue Code provides that if the beneficiary of life insurance or the recipient of property subject to a taxable power of appointment is a surviving spouse, there is no obligation to contribute to the estate tax to the extent that the property passed free of tax under the marital deduction.[56] The reorientation of policy toward exoneration of the surviving spouse's share of the probate assets that qualify for the marital deduction can be accomplished either by the legislature or by the judiciary. Since the magnitude of the change is substantial and is likely to depend on factual inquiries, the matter is more properly for legislative determination.

The United States Supreme Court in *Davis* rejected the charity's contention that federal law exempted them from paying the federal estate tax.[57] The court did not, however, preclude the possibility of state law exempting the charities from contribution. Since a deductible charitable gift does not increase the size of the taxable estate, the charitable gift, like the qualifying marital share, should be undiminished by the tax burden through the process of contribution.

The charitable deduction granted to an estate in the calculation of federal estate taxes is based upon the amount actually received by the charity.[58] Therefore, the same compounding problem discussed in connection with the marital deduction is present here.[59] When death taxes are paid from the charity's share of the residue, the charity obviously receives less than would be the case if the tax were either

55. After insuring the intended distribution of the estate a testator is most concerned with minimization of estate taxes. Comment, *Apportionment of Death Taxes: A Comprehensive Survey with Proposed Statute*, 45 TEXAS L. REV. 1348 (1967).

56. I.R.C. §§ 2206, 2207.

57. 264 U.S. at 50-51.

58. I.R.C. § 2055(a)(2).

59. I.R.C. § 2055(c). For purposes of the Ohio estate tax, OHIO REV. CODE ANN. § 5731.17(A)(4) (Page 1973) provides in pertinent part:

> If any estate, succession, or inheritance taxes are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this section, then the amount deductible under this section shall be the amount of such bequests, legacies, or devises unreduced by the amount of such taxes.

The complications present in the federal estate tax computation are avoided since the Ohio charitable deduction is not reduced by any death taxes chargeable to the charity's share.

apportioned or not charged at all. Since the amount of the charitable deduction depends upon, and is reduced by the amount of taxes paid from its share, it is evident that charging the charity through the application of the burden on the residue has two impacts. First, the estate will pay greater estate taxes since the charitable deduction is less. Second, the amount ultimately received by the charity will be less. Payment of the federal estate tax from the general estate, like other administration expenses, operates to reduce the residuary gift to charity. These results would rarely seem to be consistent with most testator's intentions.

Exonerating charitable gifts from contribution involves substantial policy considerations that are best dealt with through legislative action. Nonetheless, when the results produced by the application of the burden on the residue rule in the context of charitable gifts are inconsistent with the probable intentions of the testator, courts should not view themselves as being fettered in the application of equitable principles. In these instances, a court reasonably could find that such improbable results justify the conclusion that the testator had no actual intent with regard to fixing the estate tax burden. If the results evidence that the testator did not think about the matter, no amount of judicial construction will further intent where none exists. When the decedent has expressed no intent about the ultimate impact of the estate tax, the tax should be apportioned.

An orphan's estate tax deduction has been added to the existing estate tax deductions for marital and charitable transfers by the Tax Reform Act of 1976.[60] The orphan's deduction provides an estate tax deduction for gifts to minor children of the decedent where the following requirements are met: 1) the decedent does not have a surviving spouse; and 2) the decedent is survived by a minor child who, immediately after the death of the decedent, has no known parent.[61] Since the property interest must pass to the minor child, the same kind of potential interrelated compounding of estate taxes exists as has been discussed in connection with the marital and charitable deductions.[62] The orphan's deduction, however, is limited to the product of $5000 times the number of years the recipient orphan is under age 21 at the date of the decedent's death.[63] Thus, the potential loss through the interrelated compounding of taxes when the orphan's share is required to contribute to the payment of taxes is not as great as it is in the marital and charitable cases. Few would agree, however, that this makes the problem less serious.

60. Tax Reform Act of 1976, § 2057, Pub. L. No. 90-455, 90 Stat. 1890 (codified at I.R.C. § 2057).

61. I.R.C. § 2057(a)(1)-(2).

62. *See* text accompanying notes 51-54 *supra.*

63. I.R.C. § 2057(b).

II. ELECTION AGAINST A WILL AND THE REJECTION OF EQUITABLE APPORTIONMENT

The problem of allocating federal estate taxes is also significant in those instances in which a surviving spouse chooses to elect against the will. When a testator bequeaths less to his spouse than that which is granted under the election statute, the spouse may elect to take the statutory share in lieu of such provision.[64] Whether the electing spouse will bear any of the estate tax liability depends on whether the elective share is computed before or after the deduction of federal estate taxes. Since the elective share is based on the net estate, which is determined after the payment of estate taxes, an unnecessary complication exists because the marital deduction can not be computed until the net amount to be received by the surviving spouse is known.

The Ohio Supreme Court first considered the question of the federal estate tax burden relative to a surviving spouse's elective share in *Miller v. Hammond*.[65] Based on the statutory grant of equity power to the probate court and the failure to find statutory authority to require the surviving spouse to contribute to the payment of federal taxes, the court applied the equitable theory of proration and held that the elective share was free of the burden of federal estate taxes up to the full allowable marital deduction. Two years later the Ohio Supreme Court reconsidered the question in *Campbell v. Lloyd*[66] and overruled *Miller*.

The surviving spouse in *Campbell* elected to take against the will and the personal representative sought to determine whether federal estate taxes should be deducted before computing the elective share. Directions were not included in the decedent's will for the payment of estate taxes. Deducting federal estate taxes before computing the share results in charging the elective share with taxes since the size of the share is less than it would be otherwise. The fact that the elective share qualified for the marital deduction and did not generate estate tax liability was not thought to be controlling by the court. It reasoned that since the surviving spouse is not entitled to receive the distribution of the elective share until after the payment of debts,

64. OHIO REV. CODE ANN. § 2107.39 (Page 1976) provides in part:
After the probate of a will and the filing of the inventory, appraisement, and a schedule of debts where ordered, the probate court shall issue a citation to the surviving spouse, if any be living at the time of the issuance of the citation, to elect whether to take under the will or under section 2105.06 of the Revised Code. If the spouse elects to take under section 2105.06 of the Revised Code, the spouse shall take not to exceed one-half of the net estate unless two or more of the decedent's children or their lineal descendants survive, in which case the spouse shall take not to exceed one-third of the net estate.

65. 156 Ohio St. 475, 104 N.E.2d 9 (1952).

66. 162 Ohio St. 203, 122 N.E.2d 695 (1954), *cert. denied*, 349 U.S. 911.

including federal estate taxes, the election statute itself gave a share based on a diminished amount. Thus, the share that the electing spouse is entitled to can be computed only after the deduction of federal estate taxes.[67]

The court refused to follow the concept of equitable apportionment articulated in *Miller* and *McDougall*, reasoning that the election statute is inconsistent with its application. The election statute is framed in terms of the "net estate,"[68] and the concept of the net estate includes only that which remains of the probate estate after the payment of all debts and charges, including federal estate taxes.[69] The effect of the decision was to reduce the electing spouse's share by the federal estate tax even though the distributable assets received decreased the federal tax burden due to the applicable marital deduction.

Campbell did not decide the question whether a testamentary provision directing payment of estate taxes out of a portion of the estate bequeathed to someone other than the electing spouse requires a different view. This question was, however, resolved some years later in *Weeks v. Vandeveer*.[70] The tax clause in the testator's will directed the executor to pay all estate and inheritance taxes out of that portion of the estate remaining after his wife received her share, whether his property passed under the will or not. The surviving spouse elected against the will, but also claimed the beneficial effect of the tax clause.[71] In rejecting the spouse's claim, the court reasoned that the statute limiting the spouse's claim to a fraction of the net estate was controlling, and under *Campbell* the net estate was the portion of the probate estate remaining after the satisfaction of the obligations against the estate, including the federal estate tax. The court was of the opinion that the testator's intent on the matter was irrelevant since the election statute was designed to provide a uniform method of computing a statutory share:

> However, it is not difficult to envision a particular tax clause in a different will *detrimentally* affecting the widow's intestate share by saddling it with some or all of the burden of those taxes. Certainly the General Assembly of Ohio intended to provide a uniform rule for computing the statutory share of a surviving spouse who chooses (or is forced) to accept an intestate share. The better rule is to place all who elect to take against the will on equal footing under the statutes. Thus, the presence or absence of a tax provision in the will of a testator cannot be per-

67. *Id.* at 208, 122 N.E.2d at 698.
68. OHIO REV. CODE ANN. § 2107.39 (Page 1976).
69. 162 Ohio St. at 208, 122 N.E.2d at 698.
70. 13 Ohio St.2d 15, 233 N.E.2d 502 (1968); *accord*, Estate of Pangas, 52 T.C. 99 (1969).
71. 13 Ohio St. at 21, 233 N.E.2d at 506.

mitted to alter the statutory share of a surviving spouse electing to take against the will.[72]

Under Ohio law, therefore, the provisions of the will on the allocation of estate taxes are immaterial in determining the rights of a spouse electing against the will. The presence of a tax clause exonerating the surviving spouse does not alter the statutory share of the electing spouse. If the will directs that the surviving spouse's share is to pass free of federal estate taxes, such a tax clause in the will has no effect on the elective share and federal estate taxes are deducted in computing it.

Underlying the *Weeks* interpretation of the election statute are two fundamental premises: first, an election is a total rejection of the will and not just of the dispositive share provided the electing spouse; and second, the election statute specifies that the elective share is to be computed as a fractional portion of the net estate. As a result, the electing spouse under current law cannot claim the benefit of a tax clause that would otherwise be beneficial to the electing spouse.

A rejection of the dispositive provision by election should not be taken simultaneously as a rejection of an administrative provision. Distinguishing the rejection of the dispositive provision from the administrative provision embodied in the tax clause can be justified since the distinction permits furtherance of the decedent's wishes concerning the allocation of the tax burden. A tax clause is included in a will as a tax-saving device, and by including the clause the testator makes clear his intention to keep estate taxes as low as possible. The election should not be allowed to disrupt the testamentary plan any more than is absolutely necessary. Disruption is less when the administrative provision on the allocation of the tax burden is carried forward.

As *Weeks* indicates, the elective share is computed as a fractional portion of the net estate. A number of arguments support legislative action to change the statute so that that elective share is exonerated from contribution to estate tax liability. The most compelling argument supporting this proposition arises from consideration of the marital deduction and its relation to overall estate taxes. The result of the *Campbell* decision and Ohio's continued adherence to the policy of computing the elective share after the satisfaction of estate taxes is striking in terms of its impact on total estate taxes. Under Ohio law the size of the elective share is affected by the amount of the tax due. Since the marital deduction is not as large as it would be if the elective share were not charged with estate taxes, the

72. *Id.* at 20-21, 233 N.E.2d at 506 (emphasis in original).

estate tax liability is correspondingly greater. This problem is further aggravated by the Tax Reform Act of 1976.[73] When property passing to the electing spouse qualifies for the marital deduction the estate taxes will be less if estate taxes are disregarded in computing the elective share. To the extent that any portion of the elective share does not qualify for the marital deduction, that portion should contribute to meeting the tax burden.

The question whether the elective share is to be computed before or after deducting estate taxes is answered by a basic policy determination of the legislature. The proposition that an election is a rejection of the will should not be viewed as a serious obstacle to legislative action. The federal estate tax law provides for the full allowance of the marital deduction and the Ohio legislature should take action to insure that this deduction is obtained in full for its citizens. Absent a judicial overruling of *Campbell*, a change of this magnitude can be accomplished only by legislative action.[74]

The final arguments for not charging the elective share should be considered. The legislative policy underlying the philosophy of the election statute would be furthered by insulating the electing spouse from contribution to the extent the share qualifies for the marital deduction. The philosophy of the election statute is protection of the surviving spouse from disinheritance or inadequate testamentary provision.[75] In many instances, however, the elective share provides ineffective protection for a spouse, since the elective share is a function of the net probate estate.[76] A spouse may be effectively deprived of the statutory share by inter vivos transfers which ultimately reduce the size of the net probate estate.[77] Furthermore, the 1976 Ohio Probate Reform Act decreased the protection afforded the electing spouse relative to the protection given a spouse of a decedent dying intestate. Among other changes, the Probate Reform Act provided that a surviving spouse of an intestate decedent was entitled to a greater share of the decedent's estate than under former law.[78] The election statute allows the electing spouse to take under the statute of descent and distribution, but the election statute also imposes a maximum limit on the amount that can be taken. Since the maximum limit under the election statute was not changed by the Probate

73. *See* note 51 *supra.*

74. A statutory provision to the effect that the elective share "shall be estimated and determined before any federal estate tax is deducted or paid and shall be free and clear of such tax" is a possible approach. *See* N.C. GEN. STAT. § 30-3(a) (1976).

75. *See* T. ATKINSON, LAW OF WILLS § 33 (2d ed. 1953).

76. Smyth v. Cleveland Trust Co., 172 Ohio St. 489, 179 N.E.2d 60 (1961). *See also* Purcell v. Cleveland Trust Co., 6 Ohio App.2d 235, 217 N.E.2d 876 (1965).

77. Curry, *Intestate Succession and Wills: A Comparative Analysis of Article II of the Uniform Probate Code and the Law of Ohio*, 34 OHIO ST. L.J. 114, 134 (1973).

78. OHIO REV. CODE ANN. § 2105.06 (Page 1976).

Reform Act the increased protection under the statute of descent and distribution did not inure to the benefit of the electing spouse.

The additional benefit of simplicity in determining the estate's tax obligation would be obtained if the elective share of the surviving spouse were not charged. Charging such share with estate tax results in an interrelated tax computation that can be solved only by using an algebraic formula or by a tedious trial and error method. Interrelated tax computations can be avoided by adopting the policy of not charging the elective spouse with a portion of the estate tax liability to the extent it qualifies for the marital deduction. In an era of increasing tax complexity, simplicity is a virtue not to be ignored.

III. POLICIES TO BE REFLECTED IN THE STATUTORY METHOD OF ALLOCATION

The need for legislative action to replace the burden on the residue rule with a statutory method of apportionment has been established in the preceding parts of this article. But before the legislature adopts either partial apportionment or full apportionment it should identify the policies sought to be furthered and resolve any conflict between competing policies. This part of the article will identify the major policies that should be reflected in the statutory method of allocation and propose the adoption of the full apportionment approach contained within the Uniform Probate Code.[79]

The fundamental point of disagreement between the proponents

79. Pertinent portions of § 3-916 of the Uniform Probate Code are as follow:

(b) Unless the will otherwise provides, the tax shall be apportioned among all persons interested in the estate. The apportionment is to be made in the proportion that the value of the interest of each person interested in the estate bears to the total value of the interests of all persons interested in the estate. The values used in determining the tax are to be used for that purpose. If the decedent's will directs a method of apportionment of tax different from the method described in this Code, the method described in the will controls.

. . . .

(c)(2) If the Court finds that it is inequitable to apportion interest and penalties in the manner provided in subsection (b), because of special circumstances, it may direct apportionment thereof in the manner it finds equitable.

. . . .

(d)(1) The personal representative or other person in possession of the property of the decedent required to pay the tax may withhold from any property distributable to any person interested in the estate, upon its distribution to him, the amount of tax attributable to his interest. If the property in possession of the personal representative or other person required to pay the tax and distributable to any person interested in the estate is insufficient to satisfy the proportionate amount of the tax determined to be due from the person, the personal representative or other person required to pay the tax may recover the deficiency from the person interested in the estate. If the property is not in the possession of the personal representative or the other person required to pay the tax, the personal representative or the other person required to pay the tax may recover from any person interested in the estate the amount of the tax apportioned to the person in accordance with this Act.

(2) If property held by the personal representative is distributed prior to final apportionment of the tax, the distributee shall provide a bond or other security for the

of partial[80] and full apportionment is whether the concept of apportionment should be applied to both nonprobate and probate assets.

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apportionment liability in the form and amount prescribed by the personal representative.

(e)(1) In making an apportionment, allowances shall be made for any exemptions granted, any classification made of persons interested in the estate and for any deductions and credits allowed by the law imposing the tax.

(2) Any exemption or deduction allowed by reason of the relationship of any person to the decedent or by reason of the purposes of the gift inures to the benefit of the person bearing such relationship or receiving the gift; but if an interest is subject to a prior present interest which is not allowable as a deduction, the tax apportionable against the present interest shall be paid from principal.

(3) Any deduction for property previously taxed and any credit for gift taxes or death taxes of a foreign country paid by the decedent or his estate inures to the proportionate benefit of all persons liable to apportionment.

(4) Any credit for inheritance, succession or estate taxes or taxes in the nature thereof applicable to property or interests includable in the estate, inures to the benefit of the persons or interests chargeable with the payment thereof to the extent proportionately that the credit reduces the tax.

(5) To the extent that property passing to or in trust for a surviving spouse or any charitable, public or similar purpose is not an allowable deduction for purposes of the tax solely by reason of an inheritance tax or other death tax imposed upon and deductible from the property, the property is not included in the computation provided for in subsection (b) hereof, and to that extent no apportionment is made against the property. The sentence immediately preceding does not apply to any case if the result would be to deprive the estate of a deduction otherwise allowable under Section 2053(d) of the Internal Revenue Code of 1954, as amended, of the United States, relating to deduction for state death taxes on transfers for public, charitable, or religious uses.

(f) No interest in income and no estate for years or for life or other temporary interest in any property or fund is subject to apportionment as between the temporary interest and the remainder. The tax on the temporary interest and the tax, if any, on the remainder is chargeable against the corpus of the property or funds subject to the temporary interest and remainder.

The following outlines the method of computing estate taxes under the Tax Reform Act of 1976, Pub. L. No. 90-455, 90 Stat. 1890, [hereinafter TRA]:

Computation of Tentative Tax Base:
Taxable Estate
Add: Adjusted Taxable Gifts
Equals: Tentative Tax Base
Computation of Estate Tax:
Tentative Tax (based on tentative tax basis)
Less: Gift Taxes on all post-1976 gifts
Equals: Tentative Estate Tax before Credits
Less: Unified Credit
Equals: Gross Estate Tax
Less: Credit for State Death Taxes
Equals: Estate Tax Before Other Credits
Less: Other Credits
Equals: Net Estate Tax

The TRA requires a tentative tax base to be ascertained by combining the amount of the taxable estate with the total amount of taxable gifts made by the decedent after 1976, other than gifts includible in the decedent's gross estate—such as gifts made within three years of the decedents' death. I.R.C. § 2035, *as amended by* TRA § 2001(a)(5). Adjusted taxable gifts are included in the estate tax computation under the TRA but are not definitionally included in the Uniform Probate Code's definition of "estate." The Uniform Probate Code defines estate as "the gross estate of a decedent as determined for the purpose of federal estate tax and the estate tax payable to this state." UNIFORM PROBATE CODE § 3-916(a)(1). This definition does not take into account the TRA's inclusion of adjusted taxable gifts. Although the detailed examination of this question is beyond the scope of this article, the question for the legislature can be identified as being whether the inclusion of adjusted taxable gifts in the computation of the net estate tax requires a redefinition of the term "estate" as used in the UPC. The essence of the policy question is whether the principle of equitable apportionment, which is the underlying philosophy of the UPC, should be applied to the recipients of inter

Some time ago Professor Powell, a proponent of partial apportionment, argued that disposers of property, who are well advised, infrequently desire apportionment of federal estate taxes as to the assets passing under their wills but rather commonly desire such apportionment as to assets passing outside their wills.[81] This argument relates to the essence of the policy to be reflected in the legislative action. The most compelling policy which should be achieved by the method of allocation is the implementation of a system that most clearly coincides with the probable intentions of the majority of testators. Notwithstanding Professor Powell's argument, however, a majority of states that have adopted statutory solutions to the method of apportionment have selected full apportionment.[82]

A number of related policy considerations support the adoption of the full apportionment method of allocating estate taxes. Although the Internal Revenue Code is mostly silent on estate tax allocation, the full apportionment method is consistent with provisions of the federal estate tax that consider the problem.[83]

A decedent who dies intestate leaves no expression of intent with regard to the allocation of death taxes. Under these circumstances the impact is distributed equally since there is no justification for placing a greater burden on one part of the taxable estate than another.[84] Likewise, the Internal Revenue Code provides that the beneficiaries of the decedent's life insurance, and persons receiving property over which the decedent had a taxable power of appointment, are required to contribute proportionately to the payment of the federal estate tax, unless the testator has directed otherwise.[85] As previously discussed,[86] nonprobate assets generating estate tax liability are also required to contribute proportionately to the payment of federal estate taxes. Full apportionment is consistent in approach with the way in which these other questions of allocation are handled. Thus, it would not only promote uniformity, but would be consistent

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vivos gifts as a result of the inclusion of adjusted taxable gifts in the computation of the net estate tax.

80. Recently, a proposed statute patterned after the Massachusetts and Florida approach to apportionment was proposed for adoption in Ohio. The basic substantive impact of the adoption of the proposal would be 1) to codify the *McDougall* and *Penney* cases and 2) adopt the burden on the residue principle with the important modification that residuary assets not generating estate tax liability would not bear any tax liability. *See* Note, *The Apportionment Doctrine—A Proposed Ohio Estate Tax Apportionment Statute*, 41 U. CIN. L. REV. 897, 919-25 (1972).

81. Powell, *Ultimate Liability for Federal Estate Taxes*, [1958] WASH. U.L.Q. 327 338 (1958).

82. Twenty-eight states have enacted full apportionment statutes. *See* note 7 *supra*.

83. *See* I.R.C. §§ 2206, 2207.

84. McDougall v. Central Bank, 157 Ohio St. 45, 104 N.E.2d 441 (1952).

85. I.R.C. § 2042(b).

86. *See* text accompanying notes 39-41 *supra*.

with the concept of a single taxable estate and the essence of an estate tax lien.[87]

The policy of uniformity would also be advanced from a conflict of laws perspective by the adoption of the full apportionment method.[88] As long as state methods of allocating estate taxes differ, difficulties will exist when ancillary administration is required. When assets are left in a nondomiciliary jurisdiction, the personal representative may have to sue in a foreign forum to collect for contribution and a conflict of laws problem may result. Since a majority of jurisdictions have adopted full apportionment, the quest for general uniformity of result would be furthered by the adoption of full apportionment in Ohio.

To the fullest extent possible, the method of allocation adopted by the legislature should be aimed at avoiding unexpected results in the distribution of the decendent's estate. The justification for requiring nonprobate assets that generate estate tax liability to contribute to the payment of the tax is founded on the furtherance of this policy, being based on the assumption that the testator may not realize that nonprobate assets will be included in his estate for tax purposes.[89] Conversely, the basis for requiring the residue to bear the estate tax burden is predicated on the assumption that the testator is aware of the tax effects of his distribution scheme. Unless the premise is accepted that the testator is knowledgeably aware of the tax impact on the probate estate, partial apportionment may subject the estate to unexpected tax results and directly affect the amount available for distribution to the residuary beneficiaries. The seriousness of this ramification is increased since experience has demonstrated that in most estates the residuary legatees are the surviving spouse, children, or other dependents.[90] The assumption of knowledgeable awareness may have an adverse impact not only on those who are nearest to the decedent but who are also most likely to be the paramount objects of the testator's bounty. In contrast full apportionment avoids the apparent inconsistency of making the degree of knowledgeable awareness dependent on whether probate or nonprobate assets are involved by distributing the burden uniformly between those persons interested in the taxable estate.

The proponents of partial apportionment argue that charging the residue with estate taxes generated by the probate estate is consistent with the treatment of debts and other costs of administration. The substantial appeal of this argument centers on the similarity of estate

87. *See* I.R.C. § 6324(a)(2) and Treas. Reg. § 301.6324-1 (1972).

88. Scoles, *Estate Tax Apportionment and Conflicts*, 55 COLUM. L. REV. 261, 266 (1955).

89. Comment, *Apportionment of the Federal Estate Tax—Should North Carolina Adopt an Apportionment Statute?*, 52 N.C.L. REV. 737, 748 (1974).

90. *See* note 52 *supra* and accompanying text.

taxes to these other costs. Estate taxes are dissimilar, however, in certain important respects from these other charges traditionally paid from the residue, and these dissimilarities further the argument in favor of full apportionment. In addition to the obvious difference in the nature of an estate tax—public levy on the right to transfer property on death governed by a complex array of statutory provisions—estate taxes are distinguishable from debts and costs of administration in another fundamental respect. At the time a will is executed a testator is arguably more likely to appreciate the significance and impact of debts and costs of administration than estate taxes since the testator retains a greater degree of control over them. The government regulates the imposition of estate taxes, whereas the individual more effectively controls the other charges. As the passage of time between the execution of the will and the death of the testator becomes greater, the testator is more likely to have a continuing appreciation of the effect of other charges on the distributive scheme than estate taxes. Failure to recognize this can conflict with the policy of avoiding unexpected results.

Once the legislature decides that apportionment is desirable as a matter of policy, consideration should be given to the scope of its operation. The impact the apportionment statute will have on the elective share is one important consideration. The legislature must decide whether the apportionment statute will apply so as to exonerate the elective share from the payment of taxes when a surviving spouse elects to take against the will. Since the election statute specifically provides that the share is computed on the basis of the net estate and the Ohio Supreme Court has held that the share is to be charged with taxes,[91] enactment of an apportionment statute will result in a conflict with the election statute.

As previously discussed,[92] a number of policy arguments can be advanced in support of exonerating the elective share from estate taxes. In addition to providing the estate with the opportunity to obtain the maximum marital deduction, exoneration is consistent with the protective policy underlying the objective of the statute. Once the position that the elective share should be computed without charging it with estate taxes is accepted as being desirable, the legislature must decide whether this result will be achieved by applying the apportionment statute in election cases or by an independent amendment to the election statute.

Under the proposed apportionment statute, contained in the Uniform Probate Code, the testator can set up his own scheme of tax allocation by an express provision in his will. This statutory allow-

91. Campbell v. Lloyd, 162 Ohio St. 203, 122 N.E.2d 695 (1954).

92. *See* text accompanying notes 73-78 *supra.*

ance that preserves the testator's right to reject apportionment is in conflict with the policy of establishing a uniform rule for computing elective shares. The conflict exists since a decedent may direct that the surviving spouse is to be responsible for some or all of the death tax liability. Allowing the testator to preempt the apportionment statute, which if applicable would exonerate the elective share, would result in charging the statutory share with taxes. This result may be defended as being desirable on the basis that it furthers the expressed intention of the testator. On the other hand, allowing a particular tax clause to detrimentally affect the statutory share results in a different share for electing spouses of identical estates depending on whether or not there is an adverse tax clause in the will.

The election statute reflects the policy that in certain instances the testator's expressed testamentary provision, at the surviving spouse's option, can be rejected. The essence of election is the surviving spouse's right to take against the decedent's will. Allowing the testator to impose the death tax burden on the spouse conflicts with the concept that the testator lacks the power to affect the elective share and with the policy of placing all who elect on an equal basis under the election statute. Since the right to preempt is an essential principle underlying the apportionment statute, it is more desirable to exempt the elective share independently of the apportionment statute. Exoneration of the elective share could be accomplished by amending the election statute to provide 1) that the elective share is to be computed before any estate tax is deducted or paid and is to be free and clear of such tax, and 2) that the election shall not be governed by the apportionment statute.

IV. CONCLUSION

Under Ohio law the method of allocating the estate tax burden when a testator fails to fix the burden is primarily dependent on the elements of the taxable estate. When the taxable estate consists exclusively of probate assets the burden on the residue rule is followed. The nature of a residuary disposition is conclusively presumed to dictate charging the residuary with the estate tax liability. In three instances this conclusive presumption frustrates rather than furthers the actual intention of the testator. The first instance is when the surviving spouse is a residuary beneficiary and the spouse's share of the residuary qualifies for the marital deduction. Second, a conclusive presumption may frustrate the testator's actual intent in certain instances when a charity is a residuary beneficiary and the charity's share of the residuary qualifies for a charitable deduction. In those instances when the charity's share of the residue is either substantially depreciated or completely destroyed by charging it with estate taxes,

the burden on the residue rule produces results that are predictably inconsistent with the testator's expectations. Finally, under the new orphan's deduction when the child's share is part of the residuary it too may be depleted by estate taxes. The deduction will be lost along with the bequest to the child. In applying the burden on the residue rule the impact of estate taxes should be examined to determine whether the testator had an intent with respect to fixing the estate tax burden. If the results suggest that the testator did not have intent with respect to estate taxes, courts should not view themselves as being prevented from equitably apportioning the estate tax liability.

Under Ohio law when a surviving spouse elects to take against the will the spouse's share is charged with a pro rata share of estate taxes. This result comports with the language of the election statute, which requires the computation to be made on the basis of the net estate. This result, however, is objectionable, as a matter of policy, for a variety of reasons: 1) the approach fails to distinguish rejection of a distributive provision from an administrative provision; 2) charging the elective share results in greater estate taxes through interrelated compounding; 3) the legislative policy underlying the statutory right of election is partially frustrated; and, 4) the computation of the marital deduction is needlessly complex.

A reformulation of Ohio's approach to allocating estate taxes when a testator fails to fix the burden and when a surviving spouse elects against the will can most effectively be accomplished by legislative action. Failure by the legislature to take corrective action to insure that its citizens obtain the full marital deduction will result in the continued penalizing of its citizenry. The financial disadvantage will be exacerbated since Ohio's policy on estate tax allocation does not take into account the liberalized provisions of the marital deduction contained in the Tax Reform Act of 1976. Inaction will also continue the undesirable situation whereby the conclusive presumption underlying the judicial establishment of the burden on the residue rule is in potential conflict with a testator's actual intent with regard to the allocation of the estate tax burden.